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FINANCIAL RELATIONS

BETWEEN THE

GOVERNMENT OF INDIA

AND THE

PROVINCIAL GOVERNMENTS.

PARTS

A.—General.
B.—Taxation.

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A Memorandum presented to the Indian Statutory Commission by the Government of India on the subject of THE FINANCIAL RELATIONS BETWEEN THE GOVERNMENT OF INDIA AND THE PROVINCIAL GOVERNMENTS.

A.—General.

In the discussion of the question of the financial relations between the Government of India and the Provincial Governments, it is important to keep in view the historical circumstances under which the system of Central control has developed and also the precise nature and the object of the control that is now exercised by the Government of India. Broadly speaking, it is possible to distinguish between three classes of cases in which restrictions are now placed on the administrative authority of Provincial Governments—

(*a*) Cases in which control is exercised by the Central Government or the Secretary of State, in order difinitely to remove a particular matter from the discretion of Provincial Governments. Instances of these are the restrictions imposed by the Secretary of State over the powers of Provincial Governments in respect of expenditure and of the pay and allowances of All-India Services.

(*b*) Cases in which control is exercised for the purpose of co-ordinating the activities of Provincial Governments.

(*c*) Cases in which control by an outside authority becomes necessary owing to a conflict of interests between two Provincial Governments or between a Province and India as a whole. When such a conflict arises. interference by an outside authority, such as the Central Government or the Secretary of State, becomes essential. For instance, such a conflict might arise and has actually arisen in the exercise of the powers of taxation by Provincial Governments and local authorities subordinate to them.

A further advance towards Provincial autonomy would probably involve relaxation of the control now exercised in respect of the first class of cases, though special provisions might still have to be made in order to safeguard the interests of All-India Services. As regards the second class of

cases, it is obviously desirable that Provincial Governments should be encouraged to work on a system of co-operation for their mutual benefit. The restrictions that might be necessary in respect of such cases are similar to those which members of a co-operative body would voluntarily impose on themselves. As regards the third class, even if complete Provincial autonomy were conceded, it would be necessary to consider whether some powers of control by an outside authority should not be retained for the purpose indicated, or even whether the existing powers are adequate.

B.—Taxation.

2. *Present legal position.*—Before the Reforms every Provincial Government was bound under Section 45 of the old Government of India Act to obey the orders of the Governor-General in Council in all matters, including, of course, finance, relating to the Government of the Province. Local authorities imposed certain taxes under legislation passed by the Provincial Council with the previous approval of the Government of India, but in almost every case the imposition of such taxes was subject to any general rules made or any special orders issued by the Governor General in Council. Control by the Government of India over the powers of taxation of Provincial Governments and local authorities was thus almost unrestricted.

3. The position has been completely changed by the passage of the Government of India Act of 1919, under which by means of Statutory Rules (see Devolution Rule 14), specified sources of revenue have been placed at the disposal of Provincial Governments for the purposes of Provincial administration. These include ;

(*a*) receipts accruing in respect of Provincial subjects, such as land revenue, irrigation, judicial and non-judicial stamps, registration fees, forests, etc. It will be observed that the list of Provincial subjects includes the taxes specified in the Schedules to the Scheduled Taxes Rules and also taxes not included in those Schedules which are imposed by or under Provincial legislation which has received the previous sanction of the Governor-General. (see item 48, Part II of Schedule I to the Devolution Rules).

(*b*) The proceeds of any taxes which may be lawfully imposed for Provincial purposes.

If any *Provincial Government* now desires to supplement its revenues, it may impose, without the previous sanction of the Governor-General in Council, any of the taxes specified in the Scheduled Taxes Rules, while for any other taxes the sanction of the Governor-General is necessary. The taxes which may be levied by *local authorities* under legislation passed by a Provincial Government are specified in Schedule II of the Scheduled Taxes Rules. For facility of reference, a list of these taxes is given below :—

Taxes which may be imposed by a Provincial Legislative Council without the previous sanction of the Governor General for the purposes of the Local Government.

1. A tax on land put to uses other than agricultural.
2. A tax on succession or on acquisition by survivorship in a joint family.
3. A tax on any form of betting or gambling permitted by law.
4. A tax on advertisements.
5. A tax on amusements.
6. A tax on any specified luxury.
7. A registration fee.
8. A stamp-duty other than duties of which the amount is fixed by All-India legislation.

Taxes which a Provincial Legislative Council may impose or authorise a local authority to impose for the purposes of such local authority.

1. A toll.
2. A tax on land or land values.
3. A tax on buildings.
4. A tax on vehicles or boats.
5. A tax on animals.
6. A tax on menials and domestic servants.
7. An octroi.
8. A terminal tax on goods imported into or exported from a local area, save where such tax is first imposed in a local area in which an octroi was not levied on or before the 6th July 1917.
9. A tax on trades, professions and callings.
10. A tax on private markets.

11. A tax imposed in return for services rendered, such as

(*a*) a water rate,

(*b*) a lighting rate,

(*c*) a scavenging, sanitary or sewage rate,

(*d*) a drainage tax,

(*e*) fees for the use of markets and other public conveniences.

4. So far as the Transferred subjects (which include local taxation, and forest royalties in Burma and Bombay) are concerned, the powers of superintendence, direction and control vested in the Government of India under the Act can be exercised only for the following purposes :—

(*a*) to safeguard the administration of Central subjects,

(*b*) to decide inter-Provincial disputes, and

(*c*) to safeguard the due exercise and performance of any powers or duties possessed by or imposed on the Governor-General in Council.

5. Such in brief is the present position governing the fiscal relations between the Central Government and the Provincial Governments. In any modification of those relations the following points would have to be considered :—

(1) The Meston Committee, whose recommendations as modified by the Joint Select Committee of Lords and Commons have been given effect to in the Devolution Rules, aimed at a complete separation of the sources of revenue of the Central Government and the Provincial Governments. A complete separation, however, is theoretically as well as practically impossible, because taxes which bear different names are often similar in their incidence and economic effects. Over-lapping is inevitable under any system of allocation and it is necessary to regulate the levy of certain taxes by means of specific rules under or provisions in the Act which would aim at defining the spheres of taxation and the limits of authority of the Provincial and Central Governments.

(2) Taxes imposed by Provincial Governments under provincial legislation which had received the approval of the Government of India before the Reforms were classed under

the Devolution Rules as Provincial subjects and receipts from such taxes became automatically Provincial. Some of these taxes, such as the forest import and export duties, are indistinguishable from those allocated to the Central Government under the Meston scheme.

(3) Although a complete separation of the sources of revenue was attempted as between the Central Government and the Provincial Governments, no such separation was made so far as the sources of revenue of local authorities were concerned. Some of the taxes levied by local authorities are directly assessed on incomes (*e.g.*, profession tax) or are otherwise in the nature of Central taxes (*e.g.*, export and import terminal taxes).

(4) In some cases there has been a conflict of fiscal interests between the Central Government and the Provincial Governments arising from the fact that the separation of the sources of revenue has not been complete (*e.g.*, foreign liquor)

6. Before dealing with the problem in India, it may be useful to examine to what extent and on what principles taxation by subordinate authorities is regulated in foreign countries, particularly those the constitution of which is on a federal basis.

(1) *United States of America.*—In the U. S. A. certain restrictions are imposed by the constitution itself on the powers of the States and local authorities. The following are instances :—

(*a*) No tax or duty may be levied on articles imported from any State.

(*b*) No State may, without the sanction of the Congress, levy any imposts or duties on imports or exports except what may be absolutely necessary for executing its inspection laws. The net proceeds of all duties or imposts levied on imports or exports shall be for the use of the Treasury of the United States.

(*c*) All duties, imposts and excises shall be uniform throughout the United States.

(*d*) The Congress shall have power to regulate commerce with foreign

nations and among the several States.

It will be observed that the States can, in theory, levy indirect taxes or excises, but if they are to comply with the terms of the constitution, the conditions are almost impossible, because every other State will have to levy the same duty.

(2) *Canada.*- Under Section 92 of the Canadian constitution, the sources of revenue of the Provinces are practically restricted to direct taxation within the Province for Provincial purposes. The regulation of trade and commerce is exclusively a federal matter.

(3) *Australia.*- Under Section 51 of the constitution, the Commonwealth is given power to legislate with respect to trade and commerce and it is exclusively vested with the powers of levying duties on customs and excise.

(4) *Germany.*—In Germany, before the War, the Central Government frequently interfered by legislation with the powers of taxation of the States and local authorities (*e.g.*, under the Customs Tariff Law of 1902, octroi duties on corn, vegetables, flour, cattle, meat, etc., were abolished with effect from April 1910). The taxes on land, buildings and trade, which were allocated to local authorities, were assessed by the Central Government. Surcharges on the Central income-tax, which were collected by the Central Government, were also permitted. Under the new constitution framed after the Revolution of 1918, the Federal Government has the power of legislating for the purpose of preventing—

(*a*) loss of revenue or action prejudicial to the commercial relations of the Federation;

(*b*) double taxation;

(*c*) assessments prejudicial to imported goods as opposed to home products in dealings between separate States;

(*d*) the grant of bounties on exportation;

(*e*) the levy of charges for the use of public lines of communication which constitute a hindrance to traffic.

The financial power of the Reich is practically unlimited. The States have only those financial resources which the Reich allows to them, and any sources of State revenue already existing may be abolished or appropriated by the Reich subject to certain conditions.

(5) *Italy.*—In Italy surcharges on the Central taxes for local purposes are permitted subject to a definite maximum fixed by the Central Government in each case. So far as octroi duties are concerned, the articles which may be taxed and the maximum rates have been laid down by the Central Government.

(6) *France.*—The principal sources of local revenue in France are the octroi and the *centimes additionnels* on the State income tax. Since the Central Government collects the *centimes additionnels*, it has complete control over this tax. As regards octroi, the machinery of collection established in the bigger cities is also under Central control.

From the above brief survey it will be observed that most of the restrictions imposed by the Central Government on the powers of taxation of the constituent States in a federation are in respect of taxes on consumption and taxes which affect commerce and industry. The principles underlying these may now be briefly stated—

(1) Next to national defence, the principal motive for the formation of federations was in most cases the necessity for the maintenance of uniform conditions affecting the carrying on of trade and commerce over as large an area as possible. It is hardly necessary to emphasize the importance of this, for it is obvious that, if the taxes and charges to which commerce is subject differed greatly in different parts of the country, very serious obstacles would be placed in the way of free competition and enterprises would develop on uneconomic lines.

(2) Certain taxes are very closely interconnected with certain functions which are essentially Central, such as the negotiation of treaties with foreign countries. In order to discharge these functions, the Central Government must have full control over the duties upon goods entering or leaving the country.

(3) Thirdly, it is obvious that no State or Province should be in a position to tax the consumption of other States or Provinces. Most consumption taxes are in essence levied at the source, for they are taken over when goods are brought into the country at the customs or, if levied through an excise, when

the goods leave the place of production. In the case of many of these taxes, it is almost impossible to trace consumption of the goods. This explains why a Province or a constituent State of a federation is allowed to levy* only certain consumption taxes, such as liquor taxes, which, for other reasons, are normally transported in bond.

8. It is possible that the problem of the fiscal relations between the Central Government and the Provincial Governments in India is in some respects fundamentally different from that which federal Governments have had to solve, as India is at present a unitary State. But the following general principles, which represent in the main the experience of federal countries, in restricting the powers of taxation of Provinces and local authorities, may provide some help for a study of the Indian problem :—

(1) No Province should be in a position to tax for its own purposes anyone outside the Province.

(2) There should be as little opportunity as possible for interference by one authority in the legitimate field of the other and, as far as possible, the system should not involve the levy or collection on the authority of one Government of what another Government spends.

(3) Exercise of the powers of taxation should not result in variations in the economic conditions under which industry and commerce are carried on as between different Provinces.

(4) The Central Government should be in a position to fulfil their international obligations under commercial treaties with foreign countries.

(5) The Central Government should be in a position effectively to prevent encroachments on its fiscal sphere and to safeguard the administration of Central subjects.

(6) Where there is a conflict between the fiscal interests of a Province and those of the country as a whole, the latter should prevail.

9. The difficulties that have actually arisen in connection with the levy of certain taxes by Provincial Governments and local authorities will now be dealt with.

* The case of octroi and other consumption taxes levied by local bodies has not been overlooked here. They are governed by different considerations.

(Octroi and Terminal Taxes)

10. Octroi duties in the shape of town and market dues are one of the oldest taxes in India. These duties were in existence under the ancient Hindu rulers and they continued to be levied under the Moghuls and also under the East India Company throughout northern India. The evils of these transit duties, as they were called, were so considerably aggravated under the Company's rule, that they had become a very serious impediment to trade and commerce in the beginning of the nineteenth Century. They were abolished by Lord Ellenborough in 1842 after an elaborate enquiry conducted by Sir Charles Trevelyan. These dues had so far been levied mainly for general State purposes, but already in 1823 the Government had commenced the practice of appropriating the dues to meet the expenditure of towns, and when in the early sixties the duties were re-imposed in many places in northern India, they appeared not as items of general revenues but as the mainstay of the revenue of the towns. They have continued to be so ever since; and they have formed the subject of numerous Government Resolutions in which general principles, not always consistent with one another, have been enunciated.

11. Sir Charles Trevelyan, who became Finance Member in 1864, realised the danger of the revival of the old transit duties in the shape of town duties and issued a Resolution defining the attitude of the Government of India at that time. Subsequent Resolutions on the same subject were issued by the Government of India in 1864, 1868, 1877, 1899 and 1903. The salient features of the policy laid down in these Resolutions are as follows :—

(1) The tax was restricted to a few articles of local consumption, and the necessaries of life were to be taxed moderately.

(2) Provision was made for the refund of the octroi in the case of dutiable articles which were re-exported.

(3) Municipalities were required to provide bonded warehouses or other conveniences for the storage of goods in transit.

(4) Certain articles, such as salt, opium, liquors, liable to customs duties and imported by sea into India and also Government property were exempted from the tax.

12. In 1908 a committee, which was appointed to enquire into the question of municipal taxation in the United Provinces, examined the whole question of the levy of the octroi in great detail. They found innumerable abuses and condemned the system of octroi duties in very severe terms. Their principal recommendation was that the octroi should be abolished and a terminal tax on imports, supplemented by direct taxation, gradually substituted for it. The principal features of the terminal tax recommended by the Committee were—

(1) The tax was to be imposed on all imports at rates lower than the existing octroi rates.

(2) There were to be no refunds.

(3) There was to be no *ad valorem* assessment and the tax was to be assessed on the weight passed.

(4) It was to be collected by the railways.

(5) Passengers' luggage and parcels were to be free.

(6) Goods imported and re-booked without breaking bulk were not to be charged.

(7) A corresponding impost on goods imported by road was to be levied in the shape of a toll fixed with reference to the rates on rail-borne goods.

13. These proposals were generally approved by the Government of India after consulting the local Governments, but the recommendations of the Committee have not been carried out in full by the local authorities concerned. There has been, for instance, very little development of direct taxation in the municipalities in northern India. The Government of India themselves in their Resolution of 1917 agreed that the conversion of octroi into terminal taxes should not be regarded as a step towards direct taxation.

14. The position has been radically altered by the introduction of the Reforms. Under the Scheduled Taxes Rules, as they stand at present, a reference to the Government of India is now necessary only when a terminal tax is to be imposed for the first time in an area in which octroi was not levied on or before the 6th July 1917, but once a terminal tax has been sanctioned or in towns where the terminal tax has been substituted for octroi by the local Government, the sanction of the Government of India is not required to the revision of the rates and local Governments are free to raise them to any figure they may consider necessary.

15. The recent developments in this form of taxation as indicated by the proposals that have been made or given effect to are seriously disquieting. The following have been mentioned by the Taxation Enquiry Committee in paragraph 400 of their Report :—

(1) All pretence at imposing low rates on a few main staples has been given up. The Municipality of Nagina, for instance, in a recent schedule has proposed rates amounting to as much as Rs. 2-3-0 per maund on certain articles of apparel, rates discriminating between the produce of different countries; and a rate equal to the full tariff of 15 per cent. (prior to the passing of the Steel Protection Act) on the raw material of the chief industry of the town.

(2) In other municipalities in the United Provinces, where the terminal tax has been substituted for octroi, road tolls have been added, under which the terminal tax is collected according to the value of the contents of the carts; in other words, the evils of octroi have been reintroduced without the advantage of refunds.

(3) In certain municipalities in Bombay and the Central Provinces, a very large part of the taxation is imposed upon the main staple, cotton.

(4) In the city of Bombay, a town duty has been imposed upon the same staple, in connection with which no refund is given on exports; in other words, an export duty has been imposed upon half the export trade of the port.

(5) In Karachi, a terminal tax, which again amounts to an export duty, has been imposed on traffic passing through the port, and a similar tax has been mooted in the case of Bombay.

(6) A proposal has been made in the Presidency of Bombay for the introduction of a similar tax to be levied by local boards apparently at places which are not towns, which would thus be an undisguised transit duty.

(7) A further proposal has been made by the Bombay Excise Committee for the levy of a transit duty, both on passengers and upon

goods, as a means of restoring the excise revenue that would be lost through the introduction of prohibition.

16. In other countries it has been found necessary to regulate the levy of this form of taxation by statutory rules. The necessity for control by the Central Government is partly fiscal and partly financial. The reasons justifying control are briefly these :—

(1) In the case of import duties, which are levied by the Central Government for revenue purposes and which have reached the point of diminishing returns, an octroi or a terminal tax levied on the same articles by local authorities will affect Central revenues.

(2) In the case of terminal taxes, there is no provision for refunds in the case of articles which are re-exported. They, therefore, operate as transit duties and in the case of ports as export duties on the articles shipped at the port.

(3) In places where octroi duties are levied, the rules generally provide for refunds for articles which are re-exported, but the arrangements are apt to be so vexatious and troublesome that this form of taxation is a serious impediment to through commerce and trade.

(4) Where municipalities have been allowed to levy terminal taxes on goods exported from the town, the tax is frequently passed on to the consumer of goods outside the Municipality. A conspicuous instance in India of an attempt to carry on local services by means of taxation on non-residents is a proposal made by the District Board of Jhelum, which has within its jurisdiction the Khewra Salt Mines, to tax all salt (which is incidentally a Central Government monopoly !) exported from the district.

(5) Terminal taxes interfere with the railway administration, since the frequent variation of the rates by local authorities makes the adjustment of railway rates a difficult process. These taxes operate, in some cases, as surcharges on the railway rates.

(6) These taxes are objectionable from the point of view of incidence, since they are levied on almost all the articles of food consumed by the poorer classes. This point, however, is not of great importance so far as the necessity for control by the Central Government is concerned, but, as will be observed subsequently, this aspect has not been ignored in other countries.

(7) If an attempt is made, as has occurred in one municipality at least in India, to differentiate between foreign and indigenous articles in fixing the rates of duty, it would not be possible for the Central Government to carry out their international treaties relating to commerce.

(8) It was recently brought to the notice of the Government of India that one municipality in Sind was levying an octroi tax of Rs. 50 per maund, equivalent to about 160 per cent *ad valorem*, on imported hardened oils or "vegetable ghee", and two other local bodies in the Punjab have similarly levied rates as high as Rs. 40 per maund. These are practically prohibitive duties imposed on imports by local bodies in the guise of octroi and terminal taxes, and might be regarded as a breach of the spirit of the recent International Convention for the abolition of Import and Export prohibitions and restrictions, which India has signed.

17. The bearing of the powers of local bodies in regard to octroi and terminal taxes on the obligations undertaken by the Central Government in commercial treaties requires somewhat fuller explanation. The Government of India cannot enter independently into commercial relations with foreign countries, but the usual form of commercial treaty between Great Britain and any foreign country provides for the extension of the treaty to India on notice given by His Britannic Majesty's representative that its stipulations shall apply to India. It is common, however, for such treaties to contain a provision that no internal duties levied for the benefit of the State, local authorities, or corporations which affect, or may affect, the production, manufacture or consumption of any

article in the territories of either of the contracting parties, shall for any reason be a higher or more burdensome charge on articles the produce or manufacture of the other than on similar articles of national origin. (Article 9 of Model Form of Commercial Treaty.) Octroi and terminal duties are taken to be internal duties within the meaning of this provision. and the Government of India are not at present in a position to prevent local authorities, in the exercise of their statutory powers, from imposing these taxes at rates which differentiate between imported goods and similar articles of national origin. The Government of India might in such a case, under the provisions of Devolution Rule 49, in order to safeguard the administration of the Central subjects 'Commerce' and 'external relations', require the Local Government concerned to refrain from granting the previous sanction normally required by the various Local Self-Government Acts to the imposition of any taxation by a local authority. But the position is still unsatisfactory, for the Government of India cannot secure a modification of taxation at differential rates so imposed by local authorities in the past or imposed by oversight in the future. As an instance of treaty obligations undertaken by the Government of India and the difficulties inherent in the present position, the Commercial Treaty of 1925 between Great Britain and Siam, to which the Government of India have adhered may be quoted. That Treaty provides that internal duties levied within the territories of either of the two contracting parties for the benefit of the State or local authorities on goods, the produce or manufacture of the territories of the other party, shall not be other or greater than the duties levied in similar circumstances on the like goods of national origin. From the point of view of external relations, as well as of commerce it was important that India should adhere to the Treaty immediately, and the Government of India were compelled to risk the constitutional difficulty of enforcing this provision on local bodies.

A similar difficulty exists in the case of commercial treaties under which goods produced or manufactured in India enjoy most-favoured-nation treatment in a foreign country so long as goods produced or manufactured in that foreign country are accorded in India treatment as favourable as that accorded to goods produced or manufactured in any other foreign country. If a local authority imposed on goods produced or manufactured in a foreign

country to which India accords most-favoured-nation treatment, internal duties or restrictions which were more burdensome than the duties or restrictions imposed on the like goods of any other foreign country, it might amount to a breach of most-favoured-nation treatment.

Mention may also be made in this connection of the Barcelona Convention and Statute on Freedom of Transit, to which India is a party. Under the Statute, traffic in transit shall not be subject in the territories of the contracting parties to any special dues in respect of transit except such as are levied solely to defray expenses of supervision and administration entailed by such transit. It is therefore necessary that terminal taxes should not be levied by local bodies on goods which are merely transhipped at a railway station or port, that is, on goods for which no services are provided by the authority imposing the tax. A terminal tax in such cases might be regarded as an infringement of the Statute.

18. *Control exercised in other countries.*—Many European countries have felt the objections to these taxes to be so great that they have entirely abolished the octroi or have placed very severe restrictions on its levy. Belgium, Holland, Denmark, Sweden and Norway have replaced it by other taxes. France has made more than one unsuccessful attempt to abolish the duty. The French system is, however, free from one of the gravest objections to this tax, since there is provision for prompt refunds of the duty in the case of articles which are re-exported. The machinery for collection is also controlled by the Central Government. Restrictions on the levy of this tax were imposed in Germany by the Customs Tariff Law of 1902, under which octroi duties on corn, vegetable, flour and other mill products, cattle, meat products and fat were prohibited with effect from April 1910. In Italy the sole right of levying these duties is now given to the communes, but the articles that may be taxed and the maximum rates have been laid down by the Central Government. Indirect taxation of this sort is also prohibited under the constitution of some of the British Colonies.

19. It will be observed that, under the present constitution, the Government of India have none of the powers exercised by Central Governments in other countries to regulate the levy of the octroi and its modification, the terminal tax, by local authorities. The question of amending the law governing the levy of these taxes was considered at some length by the Indian

Taxation Enquiry Committee, who have made the following recommendations :—

(*a*) The law governing the levy of the octroi and the terminal tax should be amended so as to prohibit the introduction of octroi duties in any municipality in which they do not exist now.

(*b*) As regards the existing taxes, it is essential that control should be exercised by the Central Government in the interest of inter-Provincial trade and certain principles governing the levy of these taxes have been suggested for adoption.

20. *Abolition of the octroi.*—The principal objection to the octroi is administrative. The collection and the system of refunds, which is an essential feature of the octroi, puts the person paying the tax to a great amount of inconvenience. It is uncertain in its incidence and when it is imposed on the necessaries of life, as in India, it places a disproportionate burden on the poorer classes. It is unsatisfactory as an educative influence, since it does not encourage a sense of responsibility among the electors, who as a rule do not feel the burden of the tax. In the opinion of Sir Josiah Stamp, based on theory as well as the result of experience, " no country can be progressive that relies to any extent upon the octroi which has nearly every vice ".

The tax, however, has several important and outstanding advantages. It is sanctioned by immemorial usage and it is temperamentally suited to India. The feeling against direct taxation, particularly in northern India, is exceedingly strong. This is partly due to the fact that Indians, like some of the nations on the Continent of Europe, very strongly object to inquisitorial enquiries into their income and status, which the assessment of a direct tax involves. Moreover, direct taxation in India brings the illiterate and ignorant taxpayer into contact with an ill-paid subordinate tax-collecting agency, and the taxpayer not infrequently pays much more than what actually reaches the Exchequer. The octroi, on the other hand, is directly collected from a class which is comparatively small and the members of which are, as a rule, above the average in intelligence. They are the merchants and traders of the towns, and by force of habit and experience and by the employment of a suitable agency they have learnt to make their burden as light as possible.

The tax, moreover, is extremely productive and it would be difficult in most municipalities to obtain by any system of direct taxation as large an amount as that realised by the levy of this duty. It could be urged that if the agency of collection were under official supervision, many of the abuses which now exist could be removed, that the tax is still in existence in such advanced countries as France and Italy and that if its levy were prohibited, the development of local self-government in Northern and Western India might be seriously impeded.

21. As regards the regulation of the levy of octroi duties, the Taxation Committee have made the following recommendations:—

(*a*) The rates of taxation should be low in all cases and specially so in the case of necessaries of life and articles that are subject to Imperial or Provincial taxation.

(*b*) In order to prevent the tax from developing into a transit duty, arrangements should be made for prompt refunds on exported goods and for bonding goods intended for through transit.

(*c*) The staff should be properly paid and efficiently controlled by an official agency with which the elected representatives should have no power to interfere.

These proposals, it will be observed, involve direct interference with the administration of a Provincial Transferred subject. The following alternative suggestions have been made, which contemplate that Local Governments should be allowed to regulate the rates of taxation so long as they do not affect Central revenues or interfere with trade and commerce:—

(1) The Government of India might take power to prohibit the levy of octroi duties on certain articles on which heavy customs and excise duties are levied for Central or Provincial purposes. This is the course that has been followed in Germany and Italy for the control of these taxes. The following articles would probably be included in such a list:

Sugar, matches, kerosene oil, salt, alcoholic liquors, hemp drugs and opium.

The power taken might be comprehensive, though in practice it might probably be used only in cases of the kind indicated.

(2) The Government of India might also take power to prohibit, after adequate notice (say two or three years) the levy of octroi in municipalities where satisfactory arrangements are not made for prompt refunds on exported goods. The administrative control would still remain with the municipalities, but the Government of India would interfere in the interests of trade if the management was very inefficient.

22. As regards the terminal taxes, the Taxation Committee recommended that the following restrictions should be imposed :—

(1) The tax should be levied on all packages with reference only to weight and without reference to contents. The rate should be kept low and the Government of India, in the interests of inter-provincial traffic and railways, should retain a full measure of control.

(2) The tax should not be levied on goods imported and re-exported without break of bulk.

(3) The levy of a tax on goods exported from a municipality should not be permitted, save in exceptional cases where it is already in existence.

(4) Goods not leaving a railway yard or only leaving port premises for a railway and merely transhipped at the yard or port premises should not be subject to any duty whatever.

These restrictions are intended to prevent this tax from becoming an impediment to trade and commerce.

The difficulties pointed out above in regard to the fulfilment of Treaty obligations by the Government of India might be avoided by a statutory provision that notwithstanding anything contained in any law for the time being in force, no municipal or other local tax at variance with any treaty, convention, or engagement with any foreign State shall be imposed; and that if any tax has been or shall be so imposed, it shall to the extent of such contravention be of no effect.

23. The difficulties that have arisen in connection with the levy of octroi and terminal taxes by municipalities on Government stores might also be appropriately dealt with here. It will be observed from the history of these taxes that Government stores were generally exempt until the introduction of the reformed constitution, but local authorities have now full powers to tax them at any rate they consider justifiable. The question has assumed considerable importance owing to the endeavours of certain municipalities in the Punjab to levy the tax on telegraph and military stores of all sorts, including artillery and ammunition. This suggests that the Government of India should have power either to prohibit the levy of these taxes on Government stores or to restrict the levy to certain classes of Government stores which are primarily intended for local consumption.

24. The restrictions suggested above might be imposed in two ways :—

(*a*) They might be specifically referred to in the Scheduled Taxes Rules, or

(*b*) the levy of these taxes might be permitted subject to any restrictions that might be imposed from time to time by notification by the Government of India.

Provincial Export and Import Duties.

25. Import and export duties cannot now be imposed by Provincial Governments under the Scheduled Taxes Rules without the approval of the Governor General in Council. There are, however, certain export and import duties levied under Provincial legislation which received the approval of the Government of India before the Reforms. The proceeds of these duties are credited to Provincial revenues under Devolution Rule 14 (1) (*f*) and item 48 of Part II of Schedule I to the Devolution Rules. The following are the principal duties of this class that are now levied :—

(*a*) Under Section 39 of the Indian Forests Act of 1878, certain Local Governments have levied import duties on timber and other forest produce which is brought from any place beyond the frontier of British India. In Assam the duty may be levied on *all* forest produce whether it comes from British India or elsewhere. The justification for these import duties is mainly administrative. In the undeveloped portions of Assam and other Provinces bordering on Indian

States or foreign territories it is not possible in practice to distinguish between timber, etc., which has been cut within British India and which is liable to pay forest royalty and timber, etc., coming from outside. The imposition of an import duty diminishes the risk of payment of forest royalty being evaded. But it will be clear that the import duties must also function as protective duties and theoretically the levy of duties of such a character by a Provincial Government is obviously objectionable. The need for the imposition of these import duties, however, arises from the fact that the Central Government have not been able to maintain an effective land customs frontier. This failure on the part of the Central Government has hitherto been regarded as unavoidable for physical and geographical reasons and the Government of India therefore have so far not felt themselves to be in a position to demand that these provincial duties should be abolished.

(*b*) Under Section 32 of the Burma Forests Act of 1902, forest royalties are levied on rubber, lac and other forest produce. The royalties are, however, only charged upon produce exported and the royalty or duty is collected by the Imperial Customs Officers. These arrangements have been adopted for reasons of convenience and one important circumstance which has made it suitable to adopt them is that practically the whole of the produce is exported ; and it is only permitted to be exported from certain ports.

Since the impost is not levied on the produce consumed in Burma, it is indistinguishable from an export duty and obviously the unrestricted levy of export duties by a Provincial Government is highly objectionable on grounds of general principle. There are, however, practical difficulties in the way of the abolition of these duties. In the case of rubber, which contributes most of the revenue from this source, the royalty, the imposition of which was approved by the Government of India in 1916, was levied in pursuance of an agreement with the planters who accepted the royalty charge and the system of collecting it now in force in consideration of Government agreeing to replace a system of land revenue assessment

under which the planters were liable to a maximum rate of Rs. 25 per acre by one under which the liability of the planter in the matter of land revenue was restricted to a fixed uniform rate of Rs. 3 per acre. In other words, the duty is levied in partial substitution for land revenue assessment. Moreover, owing to the geographical features of the country, it is almost impossible to collect the various royalties in any other shape except, possibly, in the case of rubber which is grown in regular plantations. These duties are, in their economic effects, similar to land revenue assessed on gross produce.

26. Although the import and export duties referred to above are not in result seriously objectionable, it could be urged on grounds of general principle that no export or import duties or other taxes which, in their operation and economic effects, are indistinguishable from such duties, should be levied by a Provincial Government except with the approval of the Central Government and that the levy should be subject to any restrictions which may be imposed by the latter from time to time. As has been pointed out in an earlier portion of the Memorandum, provision is made for such restrictions in the constitution of the most democratic federations in Europe and elsewhere.

Taxes directly assessed on Income or Profits

27. At present no Provincial Government has power to levy any tax directly assessed on income or profits and in actual fact with the possible exception of the *thathameda* in Burma, which is a survival of an ancient regime, no Provincial taxes are now assessed directly on profits or income, though the land revenue system in some Provinces aims at an assessment based more or less on net assets or profits The question of control therefore, in the case of Provincial taxes of this nature, has not so far had to be actively considered by the Government of India. On the other hand when constitutional changes are under discussion, it may be argued that there would be considerable justification for relaxing the present absolute restrictions on the levy of such taxes. The possibility of a provincial surcharge on the Central income-tax and the connected question of the extent to which the taxing powers of provincial Governments in cases of this kind should be subject to control have been discussed in the Memorandum on the revision of the Meston Settlement. It is therefore unnecessary to deal with these points here. There are on the other hand a large number of local taxes which are

assessed on profits or income and under the law as it has stood since the Reforms the Government of India are powerless to interfere with the imposition of such taxes. Instances of these local taxes are—

(1) The Chowkidari tax in Bengal and Bihar and Orissa.

(2) The taxes on circumstances and property in Bengal, Bihar and Orissa. Assam. the U. P. and the C. P.

(3) The cess on mines in Bengal and Bihar and Orissa, which is assessed on the net profits of mines, tramways. forests, etc.

(4) The tax on professions, (levied in many provinces) which is assessed on income.

(5) The surcharge on the Central income-tax, which may be levied with the approval of the Government of India under the Madras District Municipalities Act. The Government of India, however, have not sanctioned the levy in any case.

28. The unrestricted levy of these taxes by local bodies is open to the objection that it is an encroachment on the fiscal sphere of the Central Government, one of whose principal sources of revenue is the income-tax and might in extreme cases lead to multiple taxation. On the other hand, the constitutions of most countries definitely provide for the levy of such taxes by local authorities. In fact, the Central Government in many countries has encouraged this form of taxation for local purposes. For instance—

(1) In France when the fiscal system was reformed between the years 1917-1920 and the four older taxes were replaced by a State ncome-tax, local authorities were empowered to levy *centimes additionnels* on this tax.

(2) In Germany when Dr. Von Miquel introduced his great fiscal reforms in 1893 with the assistance of prominent German economists, he stated that one of the three principles underlying these reforms was that expenditure on objects of national importance, such as, public safety, public health, primary education and poor relief, should be defrayed by means of local additions to the State income-tax.

(3) In Italy a surtax not exceeding 20 per cent. of the general income-tax is permitted for local purposes.

(4) Even in England a local income-tax as a subsidiary source of local revenue has been strongly advocated by several authorities, and it was seriously considered by the Board of Inland Revenue in 1910.

29. In India the necessity for providing additional resources for local purposes has been universally recognised, for land, which is the most important source of local revenue in other countries, is almost exclusively taxed by the Provincial Governments, local rural authorities alone being allowed to levy a small cess on the Provincial tax. It is therefore a question for consideration whether the levy of a tax directly assessed on income or profits should not be permitted to local authorities subject to such conditions as it may be necessary to impose in the interests of Central revenues. In one case in which the power to impose conditions has by accident survived to the Government of India they are proposing to make the following conditions :—

(1) The tax should be subject to a definite maximum to be fixed by the Government of India in the Act authorising its levy.

(2) The Central machinery of taxation should not be utilised either for the collection or for the assessment of tax. The object of this restriction is to emphasise to the taxpayer the distinction between the Central and the local tax.

(3) The local tax should not be allowed as a deduction in computing profits for the purpose of levying the Central income-tax.

Excise Duties.

30. The principal excise duties that are, or may be, levied by Provincial Governments or local authorities are as follows:—

(1) Excise duties on alcoholic liquors, opium and hemp drugs.

(2) An excise on specific luxuries.

(Item 6 of Schedule I of the Scheduled Taxes Rules.)

It has been held that this includes tobacco, but no tax has actually been levied on tobacco, although some of the Provincial Governments have been considering the possibility of doing so.

(3) Some local authorities levy what is described as a cess on the output of mines. (Bengal and Bihar and Orissa Mining Act, the Jharria Water Supply Act, etc.) The cess is really an excise duty on the output of mines.

31. The general principle that the excise duty on alcoholic liquors, opium and hemp drugs, should follow consumption has been accepted by the Provincial Governments by way of agreement but the Governments are at liberty to renounce this agreement, and it is for consideration whether the constitution should not be so framed as to empower the Central Government to insist upon the maintenance of this principle.

Conflicts of interest between the Central Government and the Provincial Governments have, however, arisen owing to the fact that, under the present distribution of resources, the customs duty on imported liquor goes to the Central revenues, while the fee for the privilege of selling the same liquor, whether in wholesale or retail, goes to Provincial revenues. Under the present system, therefore, it is possible for a Provincial Government to tap what is really a Central source of revenue by levying in the guise of vend fees or transport fees what is really an addition to the customs duty on imported liquor. The local Governments can also by various devices and restrictions encourage the sale of country-made foreign liquor to the detriment of the sales of imported liquor and of Central revenues. For instance :—

(1) Bombay levies a transport fee on imported liquor cleared from the Customs House in addition to the license fee for the right of vend. It has also been recently proposed to levy the license fee on a volumetric basis.

(2) In Bengal the license fees are fixed on a volumetric basis and a minimum sale price is prescribed in the case of certain liquors.

(3) In Bihar and Orissa and in the United Provinces the license fees are indirectly volumetric, being based on past transactions.

(4) In the Punjab the vend fees have a direct or indirect relation to actual sales.

(5) In the Central Provinces a minimum selling price has been fixed for imported liquors and the local Government permit the sale of certain specified brands only, this amounting to a prohibition of the

importation of other brands. In so far as the prohibited brands are the products of certain countries, this prohibition also amounts to a breach of most favoured-nation treatment.

32. There are three possible ways of dealing with the problem—

(1) The excise duty on country made foreign liquor might be transferred from the Provincial to the Imperial account, as suggested by the Taxation Committee. The proposal, however, would involve the employment of a Provincial agency to administer a Central subject and to protect Imperial interests. It would also make it difficult for Provincial Governments to deal effectively with the temperance problem, if foreign liquor and country made foreign liquor were both under the control of the Central Government.

(2) The present system under which foreign liquor is a Central source of revenue and country made foreign liquor is a Provincial source of revenue might continue, but Provincial Governments might be prohibited from

(*a*) lowering the excise duty on country made foreign liquor below the tariff rate on the corresponding imported liquor, or

(*b*) fixing a minimum sale price for any imported liquor, or

(*c*) prohibiting the importation for consumption or sale of any liquor that has paid customs duty without obtaining in each of these three cases the sanction of the Government of India.

This, however, would also involve interference with the excise policy of Provincial Governments, for if the rates of excise on country made foreign liquor were to be fixed by the Central Government, it would be difficult for the Provincial Governments to raise the excise duty on country made liquor beyond a certain figure.

(3) The customs duty on imported liquor might be abolished altogether, liquor allowed to be imported and transported in bond and Provincial Governments might be allowed to levy such excise duties as they thought fit on foreign liquor consumed in their

territories. If the sacrifice of revenue involved in this proposal could not be made by the Central Government, the local Governments might be required to make to the Central Government an assignment of a percentage of each year's excise revenue on liquor equal to the percentage that customs duty on liquor bears to the present total of customs duty and excise duty and fees.

An alternative to this would be to fix the customs duties on imported liquors on an *ad valorem* basis, such liquors being treated as a luxury article and subjected to a duty of 30 per cent. instead of the existing duties which range between 75% and 100%. Local Governments might be allowed to levy excise duties at any rate they considered necessary on foreign liquor consumed within their jurisdiction.

If either of the above two alternatives under (3) were adopted, it would be necessary in order to enable the Central Government to fulfil their obligations under existing commercial treaties with foreign Governments to impose the condition that the Provincial excise duty on country made foreign liquor should not be lower than the excise duty on imported liquor. The second of these alternatives has been accepted by the Provincial representatives who attended the annual Finance Conference held in November 1927, although it had not the political advantage that the first alternative might be able to claim if it were coupled with the assignment suggested, namely, that the extent to which the Provincial revenues would depend upon revenue from the liquor traffic would not be increased, and the Provincial Governments and the Central Government would share the loss of revenue resulting from a policy of Prohibition in the same proportions as they would share such a loss if existing arrangements were maintained.

Other Excises.

33. No Provincial duties or taxes are now levied on any luxury articles, such as tobacco, but the possibility of such taxation in the future has to be borne in mind in considering the question of the control which the Central Government should exercise over the powers of taxation of Provincial Governments. If any Provincial Government decides to levy an excise on tobacco, it is a matter for consideration

whether the Government of India should have power to ensure that the tax is levied in accordance with the principle that duty should follow consumption.

34. The local cesses based on output referred to in paragraph 29 may be theoretically unobjectionable, if such local taxation is mainly imposed on the principle of payment for services rendered. For if the cess is assessed on the total profits, a mine which is making a small profit or losing money pays little or nothing towards the local services, nor is the amount of profit any real measure of the services rendered to the mine by the local authority. To prevent the abuse of taxation based upon output, however, it would have to be considered whether the Central Government should have the power to restrict the rate of taxation to a maximum fixed by them in the Act authorising the levy of the cess: as otherwise the cess might be made to disguise what was in intention and effect an export duty or an excise duty, which the Provincial Government would not be empowered to levy directly as such.

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